

FINANCIAL STATEMENTS AND REPORT OF
INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS
MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1
OF DICKINSON COUNTY, KANSAS
DECEMBER 31, 2016 AND 2015

CONTENTS

	Page
MANAGEMENT'S DISCUSSION AND ANALYSIS	1
REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS	8
FINANCIAL STATEMENTS	
STATEMENTS OF NET POSITION	10
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION	11
STATEMENTS OF CASH FLOWS	12
NOTES TO FINANCIAL STATEMENTS	14
REQUIRED SUPPLEMENTARY INFORMATION	
SCHEDULE OF HOSPITAL'S PROPORTIONATE SHARE OF THE NET DEFINED PENSION PLAN LIABILITY	35
SCHEDULE OF HOSPITAL CONTRIBUTIONS TO DEFINED PENSION PLAN	36

MEMORIAL HEALTH SYSTEM
MANAGEMENT'S DISCUSSION AND ANALYSIS

Years Ended December 31, 2016 and 2015

Our discussion and analysis of the financial performance of Memorial Health System provides a narrative overview of the Health System's financial activities for the years ended December 31, 2016 and 2015. Please read this analysis in conjunction with the accompanying basic financial statements.

In 2015, the Health System adopted Governmental Accounting Standards Board (GASB) Statement No. 68, "Accounting and Financial Reporting for Pensions," which revised accounting and reporting standards related to pension plans and multi-employer pension plans. The 2015 and 2014 comparative financial statements were adjusted to apply this standard retrospectively. An adjustment applicable to 2013 was the first year of applying this new GASB Statement No. 68 with subsequent annual adjustments. The following chart shows the annual balances since the inception of this standard to recognize the Health Systems' proportionate share of the defined benefit pension plan unfunded pension liability.

Results of Applying GASB 68			
Year	Reduction in		Net KPERS
	operating expenses		Pension Liability
2013	Not Applicable		\$ 11,358,545
2014	\$	276,614	\$ 9,366,352
2015	\$	560,469	\$ 9,857,928
2016	\$	93,170	\$ 11,927,118

Abilene Housing, Inc. (Frontier Estates)

Abilene Housing, Inc. (AHI) was added to Memorial Health System's family of services on June 1, 2004. Financial data of Abilene Housing, Inc., are presented in "Note Q" of these financial statements. The 2016 and 2015 financial statements of Abilene Housing, Inc., were audited by Reese & Novelly, P.A.

Financial highlights

The Health System's net position decreased during 2015 by \$383,301 or 4.8% and decreased during 2016 by \$751,043 or 9.9%.

MEMORIAL HEALTH SYSTEM
MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED

Years Ended December 31, 2016 and 2015

The Health System's total operating revenue increased during each of the past two years with a \$1,956,644 or 6.9% increase in operating revenue for 2015 and a \$556,193 or 1.8% increase in operating revenue for 2016.

The increase in total operating revenue in 2015 was partially a result of increased hospital patient services revenue from occupying Phase II of new facilities for a full year and the related increased Medicare reimbursement from additional depreciation on new facilities in the context of Critical Access Hospital cost based reimbursement at 99% of costs (101% per CAH rule less 2% for sequestration) and additional revenue related to the 340B drug program.

The increase in total operating revenue in 2016 was partially a result of increased hospital and Behavioral Health Unit revenue.

The hospital became designated as a Critical Access Hospital (CAH) effective December 16, 2005. This classification change increased the 2006 and subsequent years total operating revenue due to contractual adjustments being reduced for Medicare related patients. During 2009, Memorial Health System secured the consulting services of Stroudwater Associates who calculated the CAH annual impact on the income statement to be an increase in net patient services revenue of approximately \$950,000. Management believes that the financial impact of being a CAH facility has increased in years subsequent to 2009 and even more so due to the addition of new facilities which generates additional Medicare reimbursement.

Using these financial statements

The Health System's financial statements consist of three statements – (1) Statements of Net Position; (2) Statements of Revenues, Expenses, and Changes in Net Position, and (3) Statements of Cash Flows. These financial statements and related notes provide information about the activities of the Health System, including resources held by or for the benefit of the Health System, and resources restricted for specific purposes by contributors, grantors, and indenture agreements.

One of the most important questions asked about the Health System's finances is, "Is the Health System as a whole better or worse off as a result of the year's activities?" The Statements of Net Position and the Statements of Revenues, Expenses, and Changes in Net Position report information about the Health System's resources and its activities in a way that helps answer this question. These statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. For purposes of these two statements, revenues and expenses are taken into account regardless of when cash is received or paid.

MEMORIAL HEALTH SYSTEM
MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED

Years Ended December 31, 2016 and 2015

These two statements report the Health System's net position and changes in it. The Health System's net position – the difference between assets and liabilities – may be thought of as one way to measure its financial health, or financial position. Over time, increases or decreases in the Health System's net position are one indicator of whether its financial health is improving or deteriorating. Consideration must also be given to other nonfinancial indicators, such as changes in the Health System's patient base and measures of the quality of service it provides to the community, as well as local economic factors, to assess the overall health of the Health System.

The final required statement is the Statements of Cash Flows. This statement reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and financing activities. It provides answers to such questions as "Where did cash come from?", "What was cash used for?", and "What was the change in cash balances during the reporting period?"

Assets, liabilities, and net position

The Health System's statements of net position as of the end of each of the last three years are summarized as follows:

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Assets			
Current assets	\$ 6,196,281	\$ 6,118,668	\$ 7,291,568
Assets limited as to use	1,736,933	1,738,395	1,745,777
Capital assets, net	23,935,048	26,378,572	28,440,366
Other assets	40,493	43,255	18,235
Other investments	<u>8,092,014</u>	<u>7,451,966</u>	<u>6,688,173</u>
Total assets	<u>40,000,769</u>	<u>41,730,856</u>	<u>44,184,119</u>
Liabilities			
Long-term obligations	20,080,000	20,850,000	21,600,000
Net pension liability	11,927,118	9,857,928	9,366,352
Agency funds	40,493	43,255	18,235
Current liabilities	<u>2,856,989</u>	<u>2,977,572</u>	<u>3,770,213</u>
Total liabilities	<u>34,904,600</u>	<u>33,728,755</u>	<u>34,754,800</u>
Net deferred outflows and inflows of resources			
for defined benefit pension plan	(1,988,284)	174,076	1,226,121
Deferred inflows ad valorem tax revenue	<u>273,663</u>	<u>266,192</u>	<u>258,064</u>
Total net deferred outflows and inflows of resources	<u>(1,714,621)</u>	<u>440,268</u>	<u>1,484,185</u>
Net position	<u>\$ 6,810,790</u>	<u>\$ 7,561,833</u>	<u>\$ 7,945,134</u>

MEMORIAL HEALTH SYSTEM
MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED

Years Ended December 31, 2016 and 2015

Cash and invested cash in the current asset category decreased by \$620,881 in 2015 and increased by \$117,453 during 2016. Although the cash balance is small for an organization with approximately \$40,000,000 in assets, significant additional cash is available in other investments and is held in money market accounts, certificates of deposit, and marketable securities and is readily available for day-to-day operating cash flow needs.

Assets whose use is limited by board and other investments increased by \$763,793 in 2015 and increased by \$640,048 in 2016. The increase of other investments in 2015 and 2016 was a result of depreciation being greater than the operating loss.

In aggregate, the Health System's unrestricted cash, restricted cash, and investments total \$8,571,172 and \$7,813,671 as of December 31, 2016 and 2015, respectively. This represents 106 and 98 days, respectively, of average cash expenses during each of the years then ended. Increasing these cash and investment balances shows a positive cash flow for 2015 and 2016.

The Health System's net patient accounts receivable were 61.6% of current assets as of December 31, 2016, 55.2% of current assets as of December 31, 2015, and 54.4% of current assets as of December 31, 2014. The average number of days in accounts receivable of net patient revenue was 50 days, 45 days, and 55 days as of December 31, 2016, 2015, and 2014, respectively.

At the end of 2015, the Health System had \$26,378,572 invested in capital assets, net of accumulated depreciation. Net capital assets decreased in 2015 by \$2,061,794. At the end of 2016, the Health System had \$23,935,048 invested in capital assets, net of accumulated depreciation. Net capital assets decreased in 2016 by \$2,443,524. The decrease of net capital assets was due to taking depreciation on a significant construction project that occurred over a three year period. The total cost of the construction project including monies spent on design and development was over \$24,000,000. This significant construction and replacement of key equipment has resulted in lower capital purchases in 2015 and 2016 as well as the depreciation taking in these two years.

The construction project was the largest undertaking by the Health System to date. It is the opinion of management that this addition of facilities, renovation of existing facilities, and replacement of key infrastructure items will have a positive impact on providing healthcare services in the near and long term future of the Health System. It is also the opinion of management that accessing capital and using existing cash to accomplish this largest construction project in the history of the Health System reflects well on the financial health of the organization. The completion of this project has reduced the average age of facilities of the Health System over the past two years from 13.6 years at December 31, 2012 to 6.9 years at December 31, 2016, and thus reflecting newer facilities.

MEMORIAL HEALTH SYSTEM
MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED

Years Ended December 31, 2016 and 2015

The Health System's net position decreased during 2015 by \$383,301 or 4.8% and decreased during 2016 by \$751,043 or 9.9%. The percentage of total assets financed with net position, or equity, was 17.0%, 18.1%, and 18.0% as of December 31, 2016, 2015, and 2014, respectively.

Operating results and changes in net position

The Health System's operating results and changes in net position for each of the last three years are summarized as follows:

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Operating revenues	\$ 31,040,771	\$ 30,484,578	\$ 28,527,934
Actuarial adjustment to pension expense	(93,170)	(560,469)	(276,614)
Operating expenses (net of actuarial adjustment to pension expense)	<u>31,526,401</u>	<u>31,066,734</u>	<u>28,285,022</u>
Operating income (loss)	(392,460)	(21,687)	519,526
Interest expense	(914,835)	(931,317)	(802,738)
Nonoperating revenues	556,252	538,503	690,772
Capital grants and contributions	<u>-</u>	<u>31,200</u>	<u>40,536</u>
Change in net position	<u>\$ (751,043)</u>	<u>\$ (383,301)</u>	<u>\$ 448,096</u>

The first, and most significant, component of the overall change in the Health System's net position is its operating income (loss) – generally, the difference between net patient service revenue and the expenses incurred to perform these services. The actuarial determined pension adjustment has been purposely set out so our readers may see the impact of this adjustment. If we exclude the impact of the pension adjustment, we would have reported an operating loss of \$485,630 in 2016, an operating loss of \$582,156 in 2015, and operating income of \$242,912 in 2014. The comparison of 2015 and 2014 results was partially affected by the completion of the project. Interest and depreciation expense increased in 2015 by \$392,033 as compared to 2014. In 2016, interest and depreciation expense declined by \$101,453 as compared to 2015.

MEMORIAL HEALTH SYSTEM
MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED
Years Ended December 31, 2016 and 2015

Net patient service revenue is analyzed as follows:

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Inpatient services	\$ 14,714,257	\$ 14,200,952	\$ 15,796,045
Outpatient services	<u>33,512,106</u>	<u>31,145,655</u>	<u>28,405,491</u>
Gross patient service revenue	<u>48,226,363</u>	<u>45,346,607</u>	<u>44,201,536</u>
Contractual adjustments	18,783,930	16,636,475	16,301,964
Provision for bad debts	1,301,824	1,201,000	1,102,368
Charity Care	<u>359,707</u>	<u>335,739</u>	<u>394,678</u>
Net patient service revenue	<u>\$ 27,780,902</u>	<u>\$ 27,173,393</u>	<u>\$ 26,402,526</u>

The operating performance of our Hospital is influenced by utilization, availability of physician services, third-party reimbursement rates, and patient access to third-party insurance coverage. The Hospital generated 30.5% percent of its revenue from inpatient services and 69.5% from outpatient services in 2016. This compares with total outpatient revenues of 68.7% in 2015 and 64.3% in 2014. The trend toward outpatient services has been increasing since 2008 for the Health System. This is consistent with what is happening in the health care industry. We have also added physician practices in 2010 and in 2012 that impacted the amount of revenue that we generate from outpatient services. The amounts that we have increased inpatient charge rates for the most prevalent acute care room charge was 7.3% in 2014, 6.8% in 2015, and 5.5% in 2016.

The Health System has agreements with various third-party payors that provide for payments to the Health System at amounts different from its established charge rates. These differences are referred to as contractual adjustments. Contractual adjustments continue to be a significant portion of the reduction in gross patient services revenue and have represented 38.9% for 2016, 36.7% for 2015, and 36.9% of charges for 2014. The slight decrease from 2014 to 2015 was due to the construction project and resulting increase in Medicare reimbursement due to the increased depreciation and interest costs incurred. The Medicare program, which accounts for 52 percent of the Hospital's net revenues, reimburses inpatient, swing-bed, outpatient hospital, and rural health clinic services based upon cost reimbursement methodology. Inpatient psychiatric and skilled nursing services are prospectively reimbursed.

MEMORIAL HEALTH SYSTEM
MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED
Years Ended December 31, 2016 and 2015

The Health System provides care free of charge or at amounts less than its established rates to patients who meet certain criteria under its charity care policy. Charity care write-offs have totaled \$394,678 for 2014, \$335,739 for 2015 and \$359,707 for 2016. There is a growing trend in the health care industry to identify and report the value of charity care provided to patients. Recent enactment of IRS regulation referred to as 501(r) in the past three years has increased the importance of tracking charity care for those patients who are in need of health care services but are unable to pay for those services. The provision for bad debts represented 2.70%, 2.65%, and 2.49%, of gross patient service revenue during 2016, 2015, and 2014, respectively. The combined provision for bad debt and charity care write offs was 3.4%, 3.4%, and 3.4% of gross patient services revenue for 2016, 2015, and 2014, respectively.

Employee salaries and wages increased by \$553,946 or 4.1% during 2015 and decreased by \$15,937 or .1% during 2016. The health system implemented pay raises commensurate with market conditions for 2015 and 2016, but delayed the pay increase for 2016 until mid year.

Supplies and other expenses increased during 2015 by \$1,964,312 or 16.1% and during 2016 by \$560,575 or 4.0%.

This financial report is designed to provide a general overview of the Hospital's finances and to discuss significant changes in our financial statements. If you have any questions about the report, please contact the Administration Office at the Hospital.



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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

The Board of Directors
Memorial Hospital of Hospital District #1
of Dickinson County, Kansas

We have audited the accompanying financial statements of the business-type activity of Memorial Hospital of Hospital District #1 of Dickinson County, Kansas (the Hospital), as of and for the years ended December 31, 2016 and 2015, which collectively comprise the Hospital's financial statements as listed in the table of contents, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the Kansas Municipal Audit and Accounting Guide. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to previously present fairly, in all material respects, the financial position of the business-type activity of Memorial Hospital of Hospital District #1 of Dickinson County, Kansas, as of December 31, 2016 and 2015, and the changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 1 through 7 be presented to supplement the financial statements. These standards also require a schedule of the Hospital's proportionate share of net pension liability and schedule of Hospital contributions to the defined benefit pension plan on pages 35 and 36. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context.

We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audits of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Wendling Noe Nelson & Johnson LLC

Topeka, Kansas
April 19, 2017

FINANCIAL STATEMENTS

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS
STATEMENTS OF NET POSITION
December 31,

ASSETS AND DEFERRED OUTFLOWS OF RESOURCES

	<u>2016</u>	<u>2015</u>
CURRENT ASSETS		
Cash and invested cash	\$ 479,158	\$ 361,705
Assets whose use is limited by indenture agreement - required for current liabilities	203,179	201,458
Patient accounts receivable, net of allowance for doubtful accounts of \$1,199,615 in 2016 and \$743,744 in 2015	3,818,908	3,376,492
Accounts receivable - other	295,489	379,858
Interest receivable	18,070	19,394
Estimated third-party payor settlements	386,235	735,925
Inventories	273,591	321,105
Prepaid expenses	447,988	456,539
Ad valorem taxes receivable	<u>273,663</u>	<u>266,192</u>
Total current assets	<u>6,196,281</u>	<u>6,118,668</u>
ASSETS WHOSE USE IS LIMITED		
By indenture agreement	1,940,112	1,939,853
Less amounts required for current liabilities	<u>(203,179)</u>	<u>(201,458)</u>
Noncurrent assets whose use is limited	<u>1,736,933</u>	<u>1,738,395</u>
OTHER INVESTMENTS	<u>8,092,014</u>	<u>7,451,966</u>
CAPITAL ASSETS - NET	<u>23,935,048</u>	<u>26,378,572</u>
OTHER ASSETS		
Agency funds	<u>40,493</u>	<u>43,255</u>
Total assets	<u>40,000,769</u>	<u>41,730,856</u>
DEFERRED OUTFLOWS OF RESOURCES		
Pension contributions remitted subsequent to the measurement date	592,035	604,642
Deferred outflows of resources - pension	<u>1,821,970</u>	<u>147,236</u>
Total deferred outflows of resources	<u>2,414,005</u>	<u>751,878</u>
TOTAL ASSETS AND DEFERRED OUTFLOWS OF RESOURCES	<u>\$ 42,414,774</u>	<u>\$ 42,482,734</u>

The accompanying notes are an integral part of these statements.

LIABILITIES, DEFERRED INFLOWS OF RESOURCES, AND NET POSITION

	<u>2016</u>	<u>2015</u>
CURRENT LIABILITIES		
Current maturities of long-term debt	\$ 770,000	\$ 750,000
Accounts payable	876,415	864,193
Accrued salaries, wages, and related withholding taxes payable	303,151	386,566
Accrued vacation pay	491,383	526,867
Accrued health insurance claims	161,000	151,000
Accrued interest payable	74,704	76,375
Estimated third-party payor settlements	161,000	189,000
Other current liabilities	<u>19,336</u>	<u>33,571</u>
Total current liabilities	<u>2,856,989</u>	<u>2,977,572</u>
LONG-TERM DEBT, excluding current maturities	20,080,000	20,850,000
AGENCY FUNDS	40,493	43,255
NET PENSION LIABILITY	<u>11,927,118</u>	<u>9,857,928</u>
Total liabilities	<u>34,904,600</u>	<u>33,728,755</u>
DEFERRED INFLOWS OF RESOURCES		
Deferred ad valorem tax revenue	273,663	266,192
Deferred inflows of resources - pension	<u>425,721</u>	<u>925,954</u>
Total deferred inflows of resources	<u>699,384</u>	<u>1,192,146</u>
NET POSITION		
Net investment in capital assets	2,994,693	4,778,572
Restricted for debt service	1,940,112	1,939,853
Unrestricted	<u>1,875,985</u>	<u>843,408</u>
Total net position	<u>6,810,790</u>	<u>7,561,833</u>
TOTAL LIABILITIES, DEFERRED INFLOWS OF RESOURCES, AND NET POSITION	<u>\$ 42,414,774</u>	<u>\$ 42,482,734</u>

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
Year ended December 31,

	<u>2016</u>	<u>2015</u>
Operating revenues		
Net patient service revenue	\$ 27,780,902	\$ 27,173,393
Other	<u>3,259,869</u>	<u>3,311,185</u>
Total operating revenues	<u>31,040,771</u>	<u>30,484,578</u>
Operating expenses		
Salaries and wages	14,074,495	14,090,432
Employee benefits	3,549,311	3,452,239
Actuarial adjustment to pension expense	(93,170)	(560,469)
Supplies and other	11,178,688	10,715,185
Depreciation and amortization	<u>2,723,907</u>	<u>2,808,878</u>
Total operating expenses	<u>31,433,231</u>	<u>30,506,265</u>
Operating loss	<u>(392,460)</u>	<u>(21,687)</u>
Nonoperating revenues (expenses)		
Ad valorem taxes	298,529	293,830
Noncapital contributions	131,640	142,565
Investment income	91,595	69,665
Interest expense	(914,835)	(931,317)
Other	<u>34,488</u>	<u>32,443</u>
Nonoperating revenues (expenses), net	<u>(358,583)</u>	<u>(392,814)</u>
Excess of expenses over revenues before capital contributions	(751,043)	(414,501)
Capital contributions	<u>31,200</u>	<u>31,200</u>
Change in net position	(751,043)	(383,301)
Net position at beginning of year	<u>7,561,833</u>	<u>7,945,134</u>
Net position at end of year	<u>\$ 6,810,790</u>	<u>\$ 7,561,833</u>

The accompanying notes are an integral part of these statements.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

STATEMENTS OF CASH FLOWS

Year ended December 31,

	<u>2016</u>	<u>2015</u>
Cash flows from operating activities		
Receipts from and on behalf of patients	\$27,660,176	\$27,568,971
Payments to or on behalf of employees	(17,732,705)	(17,784,996)
Payments to suppliers	(11,200,757)	(10,935,114)
Other receipts and payments	<u>3,330,003</u>	<u>3,370,539</u>
Net cash provided by operating activities	<u>2,056,717</u>	<u>2,219,400</u>
Cash flows from noncapital financing activities		
Ad valorem taxes	298,529	293,830
Noncapital contributions	131,640	142,565
Other nonoperating receipts	<u>34,094</u>	<u>18,131</u>
Net cash provided by noncapital financing activities	<u>464,263</u>	<u>454,526</u>
Cash flows from capital and related financing activities		
Purchase of capital assets	(196,669)	(1,244,718)
Contributions for purchase of capital assets		31,200
Proceeds from sale of assets	7,036	26,923
Repayment of long-term debt	(750,000)	(730,000)
Interest paid	<u>(916,506)</u>	<u>(932,664)</u>
Net cash used by capital and related financing activities	<u>(1,856,139)</u>	<u>(2,849,259)</u>
Cash flows from investing activities		
(Increase) decrease in assets whose use is limited	(259)	245,769
Increase in investments	(630,217)	(746,879)
Investment income	<u>83,088</u>	<u>55,562</u>
Net cash used by investing activities	<u>(547,388)</u>	<u>(445,548)</u>
Net change in cash and cash equivalents	117,453	(620,881)
Cash and cash equivalents at beginning of year	<u>361,705</u>	<u>982,586</u>
Cash and cash equivalents at end of year	<u>\$ 479,158</u>	<u>\$ 361,705</u>

The accompanying notes are an integral part of these statements.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS
STATEMENTS OF CASH FLOWS - CONTINUED
Year ended December 31,

	<u>2016</u>	<u>2015</u>
Reconciliation of operating loss to net cash provided by operating activities		
Operating loss	\$ (392,460)	\$ (21,687)
Adjustments to reconcile operating loss to net cash provided by operating activities		
Depreciation and amortization	2,723,907	2,808,878
Provision for bad debts	1,301,824	1,201,000
Changes in		
Patient and other accounts receivable	(1,659,871)	(530,151)
Estimated third-party payor settlements	321,690	(196,925)
Inventories and prepaid expenses	56,065	(155,975)
Accounts payable and accrued expenses	(201,268)	(325,271)
Net pension liability, deferred inflows, and deferred outflows related to defined benefit pension plan	<u>(93,170)</u>	<u>(560,469)</u>
Net cash provided by operating activities	<u>\$ 2,056,717</u>	<u>\$ 2,219,400</u>

The accompanying notes are an integral part of these statements.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS

December 31, 2016 and 2015

NOTE A - SUMMARY OF ACCOUNTING POLICIES

A summary of the significant accounting policies consistently applied in the preparation of the accompanying financial statements follows.

1. Financial reporting entity

Memorial Hospital of Hospital District #1 of Dickinson County, Kansas (Hospital), is a municipal corporation operating an acute-care hospital located in Abilene, Kansas, with a licensed bed capacity of 25 acute care beds and 10 psychiatric beds and a long-term care facility with a licensed bed capacity of 74 beds. The Hospital also operates a physician clinic located in Abilene, Kansas. The Hospital is governed by an elected five-member Board of Directors.

2. Component units

Abilene Housing, Inc. (AHI), was formed and organized as a Kansas not-for-profit corporation. AHI provides housing for elderly and handicapped persons in a 60-unit apartment project located in Abilene, Kansas, and provides services specifically designed to meet the physical, social, and psychological needs of those individuals. Effective June 1, 2004, membership of AHI's Board consists of one member of the Board of Directors of the Hospital, the Chief Executive Officer of the Hospital, and the Chief Financial Officer, Chief Operating Officer, or Chief Nursing Officer of the Hospital.

The Hospital is financially accountable for AHI since the Hospital appoints a majority of AHI's Board and the Hospital employs an individual responsible for AHI's day-to-day operations. The Hospital does not have access to AHI's resources and is not legally obligated for AHI's long-term debt.

Condensed financial statements of AHI are presented in Note Q. Separate financial statements are not available for public distribution.

The Memorial Health Foundation (Foundation) was formed and organized as a Kansas not-for-profit corporation on August 6, 2013. This Foundation is organized for specific health care purposes and is intended to be an auxiliary association and supporting organization for the financial aid and assistance of the Hospital and all of its component or affiliated organizations and other causes and institutions. This Foundation is organized exclusively for charitable, educational, and scientific purposes, including, but not limited to, the sponsorship of specific projects and programs to improve healthcare services in the geographic area served by the Hospital.

3. Basis of accounting

The Hospital utilizes the proprietary fund method of accounting whereby revenues and expenses are recognized on the accrual basis. Substantially all revenues and expenses are subject to accrual.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2016 and 2015

NOTE A - SUMMARY OF ACCOUNTING POLICIES - Continued

4. Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

5. Cash equivalents

All cash and invested cash, excluding assets whose use is limited and investments, are considered to be cash equivalents.

6. Patient accounts receivable

The Hospital reports patient accounts receivable for services rendered at net realizable amounts from third-party payors, patients, and others. The Hospital provides an allowance for doubtful accounts based upon a review of outstanding receivables, historical collection information, and existing economic conditions.

7. Inventories

Inventories are stated at cost as determined on the first-in, first-out method.

8. Investments in debt and equity securities

Investments in debt and equity securities are carried at fair value. Interest, dividends, and gains and losses, both realized and unrealized, on investments in debt and equity securities are included in nonoperating investment income.

9. Capital assets

Capital assets are stated at cost. Depreciation and amortization of capital assets is provided on the straight-line method over the estimated useful lives of the assets. The estimated lives used are generally in accordance with the guidelines established by the American Hospital Association.

The costs of maintenance and repairs are charged to operating expenses as incurred. The costs of significant additions, renewals, and betterments to depreciable properties are capitalized and depreciated over the remaining or extended estimated useful lives of the item or the properties. Gains and losses on disposition of capital assets are included in nonoperating revenues and expenses.

10. Costs of borrowing

Interest costs incurred on borrowed funds during the period of construction of capital assets are capitalized as a component of the cost of acquiring those assets. Costs incurred in connection with the issuance of long-term debt are expensed in the period incurred.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2016 and 2015

NOTE A - SUMMARY OF ACCOUNTING POLICIES - Continued

11. Accrued health insurance claims

The Hospital is partially self-insured for health insurance claims of its employees (Note O). Management estimates a liability for reported and unreported claims incurred as of the end of each reporting period. The estimate is based on known claims and historical claims experience.

Although management believes the estimate for accrued health insurance claims is reasonable, it is possible that actual incurred claims expense may vary significantly from the estimate included in the accompanying financial statements.

12. Pension plan

The Hospital participates in the Kansas Public Employees Retirement System Plan (KPERS), a cost sharing multiple employer defined benefit pension plan. The Hospital uses information provided by KPERS to measure the net pension liability, deferred outflows of resources, and deferred inflows of resources of the KPERS pension plan.

Deferred outflows of resources represents a consumption of net position that applies to a future period and so will not be recognized as an expense or expenditure until then. Deferred inflows of resources represent an acquisition of net position that applies to a future period and so will not be recognized as revenue until then.

13. Net position

Net position is classified in three components. "Net investment in capital assets" consists of capital assets net of accumulated depreciation and reduced by the balances of any outstanding borrowings used to finance the purchase or construction of those assets. "Restricted net position" is the noncapital net position that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the Hospital including amounts deposited with trustees as required by indenture agreements. "Unrestricted net position" is the remaining net position that does not meet the definition of "net investment in capital assets" or "restricted."

14. Operating revenues and expenses

The statement of revenues, expenses, and changes in net position distinguishes between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services, which is the Hospital's principal activity. Nonexchange revenues, including taxes, grants, and contributions received for purposes other than capital asset acquisition, are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide health care services, other than financing costs.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2016 and 2015

NOTE A - SUMMARY OF ACCOUNTING POLICIES - Continued

15. Net patient service revenue

Net patient service revenue is reported at established charges with deductions for discounts, charity care, the provision for bad debts, and contractual adjustments, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

16. Charity care

The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

17. Ad valorem taxes

The Hospital receives financial support from ad valorem taxes. Ad valorem taxes are assessed in November of each year and are available for use by the Hospital in the following year.

18. Income taxes

The Hospital is exempt from federal income taxes pursuant to Sections 115 and 501(a) of the Internal Revenue Code.

19. Subsequent events

The Hospital has evaluated subsequent events through the date of the independent certified public accountants' report, which is the date the financial statements were available to be issued.

NOTE B - REIMBURSEMENT PROGRAMS

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established charge rates. The amounts reported on the statements of net position as estimated third-party payor settlements consist of the estimated differences between the contractual amounts for providing covered services and the interim payments received for those services. A summary of the payment arrangements with major third-party payors follows:

Medicare - The Hospital is a critical access hospital for purposes of the Medicare program. Inpatient and outpatient acute care services, skilled nursing swing-bed services, and rural health clinic (RHC) services rendered to Medicare beneficiaries are paid under cost reimbursement methodologies.

Geriatric psychology services and skilled nursing services, provided at the Hospital's long-term care facility, are paid based on prospectively determined per diem rates. Physician services, other than RHC services, rendered to Medicare beneficiaries are paid based on a prospectively determined fee schedule.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2016 and 2015

NOTE B - REIMBURSEMENT PROGRAMS - Continued

The Hospital is paid for cost reimbursable items at tentative rates with final settlement determined after submission of annual cost reports by the Hospital and audits or reviews thereof by the Medicare administrative contractor. The Hospital's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization. The Hospital's Medicare cost reports have been audited or reviewed by the Medicare administrative contractor through December 31, 2014.

Medicaid - Hospital and RHC services rendered to all Medicaid program beneficiaries are paid at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors.

Nursing facility services are paid at prospectively determined per diem rates set annually on the basis of cost information from preceding calendar years.

Blue Cross and Blue Shield - All services rendered to patients who are insured by Blue Cross and Blue Shield are paid on the basis of prospectively determined rates per discharge or discounts from established charges.

The Hospital has also entered into payment agreements with certain commercial insurance carriers and preferred provider organizations. The basis for payment to the Hospital under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

A summary of gross and net patient service revenue follows:

	<u>2016</u>	<u>2015</u>
Gross patient service revenue	\$48,226,363	\$45,346,607
Adjustments to patient service revenue		
Third-party contractual adjustments,		
discounts, and allowances	(18,783,930)	(16,636,475)
Provision for bad debts	(1,301,824)	(1,201,000)
Charity care	<u>(359,707)</u>	<u>(335,739)</u>
Net patient service revenue	<u>\$27,780,902</u>	<u>\$27,173,393</u>

Revenue from the Medicare and Medicaid programs accounted for approximately 52 percent and 11 percent, respectively, of the Hospital's net patient service revenue during 2016, and 50 percent and 12 percent, respectively, of the Hospital's net patient service revenue during 2015. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates could change by a material amount in the near term.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2016 and 2015

NOTE C - ELECTRONIC HEALTH RECORD INCENTIVE PAYMENTS

The American Recovery and Reinvestment Act of 2009 (ARRA) provides for incentive payments under the Medicare and Medicaid programs for certain hospitals and physician practices that demonstrate meaningful use of certified electronic health record (EHR) technology. These provisions of ARRA are intended to promote the adoption and meaningful use of interoperable health information technology and qualified EHR technology.

The Hospital recognizes revenue for EHR incentive payments when the hospital facility and physician practices have attested that they have demonstrated meaningful use of certified EHR technology for the applicable period and complied with the reporting conditions to receive the payments. The demonstration of meaningful use is based upon meeting a series of objectives and varies between hospital facilities and physician practices and between the Medicare and Medicaid programs. Additionally, meeting the objectives in order to demonstrate meaningful use becomes progressively more stringent as its implementation is phased in through stages as outlined by Centers for Medicare & Medicaid Services. The Hospital recognized \$10,580 and \$193,058 of revenue for EHR incentive payments during the years ended December 31, 2016 and 2015, respectively. These amounts are included in other operating revenues.

The Hospital incurs both capital expenditures and operating expenses in connection with the implementation of its EHR incentives. The amounts and timing of these expenditures do not directly correlate with the timing of the Hospital's recognition of EHR payments as revenue.

NOTE D - ASSETS WHOSE USE IS LIMITED BY INDENTURE AGREEMENT

Assets whose use is limited by indenture agreement consist of money market mutual funds that are held by a trustee under bond indenture agreements. Amounts that are required for obligations classified as current liabilities are reported in current assets.

NOTE E - INVESTMENTS

Investments are summarized as follows:

	<u>2016</u>	<u>2015</u>
Invested cash consisting of bank		
certificates of deposit, bank savings		
accounts, and money market mutual fund	\$6,780,281	\$6,093,968
Common stock at fair value	24,188	23,396
Equity interest in Mobile Clinical		
Services, Inc.	160,842	142,567
Corporate bonds at fair value	1,117,660	1,183,827
Abilene Community Foundation		
Endowment fund	9,043	8,208
	<u>\$8,092,014</u>	<u>\$7,451,966</u>

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS
NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2016 and 2015

NOTE E - INVESTMENTS - Continued

The Hospital received contributions from an outside trust consisting of common stock and corporate bonds. The outside trustee stipulated that the Hospital board administer the resources created by the contributions separate from public monies held by the Hospital and that the assets be invested with the goal of maximizing the benefit to the Hospital by retaining the securities in their existing form through their maturities and placing the assets in similar high-grade securities in the future. Restrictions on the use of the contributions have been met and the investments are now unrestricted as to their use by the Hospital.

The Hospital has a 20-percent ownership interest in Mobile Clinical Services, Inc., (MCSI). The Hospital's equity in undistributed net earnings of MCSI since acquisition is \$160,842. Nuclear medicine and ultrasound services are provided to the Hospital through arrangements with MCSI. Total fees charged to operating expense for these services were approximately \$52,000 in 2016 and \$55,000 in 2015. Amounts payable to MCSI for these services were insignificant at December 31, 2016 and 2015.

NOTE F - CAPITAL ASSETS

Capital asset additions, retirements, and balances are as follows:

	2016			
	<u>Beginning balance</u>	<u>Additions/ transfers</u>	<u>Retirements</u>	<u>Ending balance</u>
Land	\$ 875,757	\$ -	\$ -	\$ 875,757
Land improvements	1,440,754			1,440,754
Buildings	30,196,435	43,013		30,239,448
Major movable equipment	<u>9,872,828</u>	<u>244,012</u>	<u>39,550</u>	<u>10,077,290</u>
Totals at historical cost	<u>42,385,774</u>	<u>287,025</u>	<u>39,550</u>	<u>42,633,249</u>
Less accumulated depreciation				
Land improvements	522,589	78,288		600,877
Buildings	8,735,480	1,752,424	(6,642)	10,494,546
Major movable equipment	<u>6,749,133</u>	<u>893,195</u>	<u>39,550</u>	<u>7,602,778</u>
Total accumulated depreciation	<u>16,007,202</u>	<u>2,723,907</u>	<u>32,908</u>	<u>18,698,201</u>
Capital assets, net	<u>\$26,378,572</u>	<u>\$ (2,436,882)</u>	<u>\$ 6,642</u>	<u>\$23,935,048</u>

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2016 and 2015

NOTE F - CAPITAL ASSETS - Continued

	2015			
	<u>Beginning balance</u>	<u>Additions/ transfers</u>	<u>Retirements</u>	<u>Ending balance</u>
Land	\$ 875,757	\$ -	\$ -	\$ 875,757
Land improvements	1,198,404	242,350		1,440,754
Buildings	27,487,339	2,913,930	204,834	30,196,435
Major movable equipment	9,707,481	220,143	54,796	9,872,828
Totals at historical cost	<u>39,268,981</u>	<u>3,376,423</u>	<u>259,630</u>	<u>42,385,774</u>
Less accumulated depreciation				
Land improvements	436,368	86,221		522,589
Buildings	7,193,434	1,748,834	206,788	8,735,480
Major movable equipment	5,815,541	973,823	40,231	6,749,133
Total accumulated depreciation	<u>13,445,343</u>	<u>2,808,878</u>	<u>247,019</u>	<u>16,007,202</u>
Construction in progress and planning costs	<u>2,616,728</u>	<u>(2,616,728)</u>	<u>-</u>	<u>-</u>
Capital assets, net	<u>\$28,440,366</u>	<u>\$ (2,049,183)</u>	<u>\$ 12,611</u>	<u>\$26,378,572</u>

NOTE G - DEFERRED AD VALOREM TAX REVENUE

Deferred ad valorem tax revenue is levied in November but not available for expenditure in the current period.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS
NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2016 and 2015

NOTE H - LONG-TERM DEBT

Long-term debt consists of the following:

	<u>2016</u>	<u>2015</u>
2.35% - 4.40% Hospital District No. 1, Dickinson County, Kansas Lease Agreement Certificates of Participation, Series 2011; issued on December 1, 2011, in the original amount of \$6,000,000; due serially through December 1, 2021	\$ 3,520,000	\$ 4,160,000
1.40% - 4.30% Abilene, Kansas Public Building Commission Revenue Bonds, Series 2011; issued on December 1, 2011, in the original amount of \$7,760,000; due serially through December 1, 2028	7,330,000	7,440,000
4.45% - 5.03% Abilene, Kansas Public Building Commission Revenue Bonds, Series 2012; issued on January 5, 2012, in the original amount of \$10,000,000; due serially through December 1, 2035, with principal payments beginning on December 1, 2028	<u>10,000,000</u>	<u>10,000,000</u>
	20,850,000	21,600,000
Less current maturities	<u>770,000</u>	<u>750,000</u>
Long-term debt, excluding current maturities	<u>\$20,080,000</u>	<u>\$20,850,000</u>

The following is a summary of changes in long-term debt:

Outstanding at January 1, 2015	\$22,330,000
Principal payments	<u>(730,000)</u>
Outstanding at December 31, 2015	21,600,000
Principal payments	<u>(750,000)</u>
Outstanding at December 31, 2016	<u>\$20,850,000</u>

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2016 and 2015

NOTE H - LONG-TERM DEBT - Continued

On December 1, 2011, the Abilene, Kansas Public Building Commission issued \$7,760,000 in Revenue Bonds, Series 2011 (the 2011 PBC bonds) and on January 5, 2012, issued \$10,000,000 in Revenue Bonds, Series 2012 (the 2012 PBC bonds), for the benefit of the Hospital pursuant to a Trust Indenture dated December 1, 2011. On December 1, 2011, the Hospital issued its Lease Agreement Certificates of Participation, Series 2011 (the Certificates), pursuant to a Trust Indenture dated December 1, 2011. The Certificates represent proportionate interests of the owners thereof in basic rent payments to be made by the Hospital. The proceeds of the 2011 PBC bonds, the 2012 PBC bonds, and the Certificates (collectively the project debt) will be used, together with other available funds of the Hospital, to (1) pay for renovations and additions to the Hospital's facilities, (2) purchase certain medical equipment, (3) fund a debt service reserve fund for the project debt, (4) pay interest costs during the period of construction, and (5) pay for certain costs related to issuance of the project debt.

The indenture agreement requires the Hospital to transfer to a trustee, on a monthly basis, specified amounts which, when combined with interest earned on the respective funds held by the trustee, will provide sufficient funds to pay the principal and interest on the appropriate due dates. Such transfers were made and are included in assets whose use is limited. The obligations of the Hospital under the indenture agreement are secured by a pledge of its unrestricted revenues, subject to the right of the Hospital to dispose of or encumber property as defined and permitted in the indenture agreement. The indenture agreement also includes certain restrictive covenants relating to the disposition of property, adequacy of insurance coverage, incurrence of additional indebtedness, the level of days cash on hand, and the level of fees and rates charged. The covenant in the indenture agreement regarding the level of fees and rates charged requires that fees and rates for services be set at levels sufficient for the Hospital to produce income available for debt service in each fiscal year equal to 125 percent of the debt service requirements during that fiscal year for outstanding debt.

Scheduled annual debt service requirements on long-term debt are as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2017	\$ 770,000	\$ 896,451	\$ 1,666,451
2018	790,000	873,306	1,663,306
2019	815,000	847,489	1,662,489
2020	845,000	818,129	1,663,129
2021	880,000	784,786	1,664,786
2022-2026	4,910,000	3,409,559	8,319,559
2027-2031	5,975,000	2,336,499	8,311,499
2032-2035	5,865,000	754,755	6,619,755
	<u>\$20,850,000</u>	<u>\$10,720,974</u>	<u>\$31,570,974</u>

NOTE I - LEASES

The Hospital leases property and equipment under operating lease arrangements. Total lease expense under all operating leases was approximately \$28,000 for 2016 and \$33,000 for 2015.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2016 and 2015

NOTE J - RISK MANAGEMENT

The Hospital is insured for professional liability under a comprehensive hospital liability policy provided by an independent insurance carrier with limits of \$200,000 per occurrence up to an annual aggregate of \$600,000 for all claims made during the policy year. The Hospital is further covered by the Kansas Health Care Stabilization Fund for claims in excess of its comprehensive hospital liability policy up to \$300,000 pursuant to any one judgment or settlement against the Hospital for any one party, subject to an aggregate limitation for all judgments or settlements arising from all claims made in the policy year in the amount of \$900,000. All coverage is on a claims-made basis. The above policies have been renewed through January 1, 2018. The Hospital intends to renew this coverage on that date and is aware of no reason why such coverage would be denied at that time.

The Hospital has entered into a self-insured trust agreement with the Kansas Hospital Association, along with other qualified hospitals in the State of Kansas. The purpose of this trust is to purchase workers' compensation insurance for employees. To the extent the trust would have been unable to meet its claims liabilities, members have, jointly and severally, agreed to pay for all claims. Management has assessed the financial condition of the trust and believes that the trust is sufficiently funded to meet its liabilities as they come due as of December 31, 2016. Management is not aware of any intention by the trust to implement an assessment in the future for past funding shortages.

In addition to the risk disclosed elsewhere in these financial statements and notes thereto, the Hospital is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Hospital purchases commercial insurance for these risks. Settled claims have not exceeded this commercial coverage in any of the past three years.

NOTE K - DEPOSITS WITH FINANCIAL INSTITUTIONS

Kansas statutes authorize the Hospital, with certain restrictions, to deposit or invest in open accounts, time deposits, certificates of deposit, repurchase agreements, the State Treasurer's municipal investment pool, and U.S. Treasury bills and notes. Also, statutes generally require that financial institutions pledge securities with a market value equal to total deposits, except for monies acquired through the receipt of grants, donations, bequests, and gifts, in excess of F.D.I.C. coverage at any given time and the securities pledged be deposited with a Kansas state or national bank or trust company, the Federal Reserve Bank, the Federal Home Loan Bank, or the Kansas State Treasurer.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2016 and 2015

NOTE K - DEPOSITS WITH FINANCIAL INSTITUTIONS - Continued

The carrying amount of the Hospital's deposits with financial institutions was \$5,445,405 and the bank balances were \$5,932,581 at December 31, 2016. The bank balances are categorized as follows at December 31, 2016:

Amount insured by the F.D.I.C., or collateralized with securities held by the Hospital or by its agent in the Hospital's name	\$ 622,424
Uncollateralized (amount collateralized with securities held in safekeeping by an authorized depository other than the pledging financial institution's trust department, but not in the Hospital's name)	<u>5,310,157</u>
	<u>\$ 5,932,581</u>

NOTE L - CONCENTRATION OF CREDIT RISK

The Hospital grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors is as follows:

	<u>2016</u>	<u>2015</u>
Medicare	36%	38%
Medicaid	9	8
Blue Cross	16	11
Other third-party payors	12	13
Patients	<u>27</u>	<u>30</u>
	<u>100%</u>	<u>100%</u>

NOTE M - BUDGETARY COMPARISON

Kansas statutes require that a fixed annual operating budget be legally adopted for the Hospital. All legal annual operating budgets are prepared using the modified accrual basis of accounting, modified further by the encumbrance method of accounting. Revenues are recognized when cash is received. Expenditures include disbursements, accounts payable, and encumbrances. Encumbrances are commitments by the Hospital for future payments and are supported by a document evidencing the commitment, such as a purchase order or contract. All unencumbered appropriations lapse at year-end. Actual expenditures for the year ended December 31, 2016, on the modified accrual basis of accounting and encumbrances were \$29,908,420 as compared to the legally adopted budgeted expenditures of \$35,743,736. Actual expenditures for the year ended December 31, 2015, on the modified accrual basis of accounting and encumbrances were \$29,544,371 as compared to the legally adopted budgeted expenditures of \$32,026,866.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2016 and 2015

NOTE N - DEFINED BENEFIT PENSION PLAN

Plan description

The Hospital participates in the Kansas Public Employees Retirement System (KPERS), a cost-sharing multiple-employer defined benefit pension plan as provided by K.S.A. 74-4901, etc. seq. Substantially all employees of the Hospital are eligible to participate in KPERS. KPERS provides retirement benefits, life insurance, disability income benefits, and death benefits. Kansas law establishes and amends benefit provisions. Substantially all public employees in Kansas are covered by KPERS. Participation by local political subdivisions and entities is optional, but irrevocable once elected. KPERS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to KPERS (611 South Kansas Avenue, Suite 100, Topeka, Kansas 66603-3869) or by calling 1-888-275-5737.

Benefits

Benefits are established by statute and may only be changed by the Kansas Legislature. Members with ten or more years of credited service, may retire as early as age 55, with an actuarially reduced monthly benefit. Normal retirement is at age 65, age 62 with ten years of credited service, or whenever a member's combined age and years of credited service equal 85 "points."

Monthly retirement benefits are based on a statutory formula that includes final average salary and years of service. When ending employment, members may withdraw their contributions from their individual accounts, including interest. Members who withdraw their accumulated contributions lose all rights and privileges of membership. For all pension coverage groups, the accumulated contributions and interest are deposited into and disbursed from the membership accumulated reserve fund as established by K.S.A. 74-4922.

Members choose one of seven payment options for their monthly retirement benefits. At retirement a member may receive a lump-sum payment of up to 50 percent of the actuarial present value of the member's lifetime benefit. His or her monthly retirement benefit is then permanently reduced based on the amount of the lump sum. Benefit increases, including ad hoc post-retirement benefit increases, must be passed into law by the Kansas Legislature. Benefit increases are under the authority of the Legislature and the Governor of the State of Kansas. For all pension coverage groups, the retirement benefits are disbursed from the retirement benefit payment reserve fund as established by K.S.A. 74-4922.

Contributions

Member contributions are established by state law, and are paid by the employee according to the provisions of Section 414(h) of the Internal Revenue Code. State law provides that the employer contribution rates be determined based on the results of an annual actuarial valuation for each of the three state-wide pension groups. The contributions and assets of all groups are deposited in the Kansas Public Employees Retirement Fund established by K.S.A. 74-4921. All of the retirement systems are funded on an actuarial reserve basis.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2016 and 2015

NOTE N - DEFINED BENEFIT PENSION PLAN - Continued

Effective July 1, 2009 KPERS has two benefit structures and funding depends on whether the employee is a Tier 1 or Tier 2 member. Tier 1 members are active and contributing members hired before July 1, 2009. Tier 2 members were first employed in a covered position on or after July 1, 2009. Kansas law establishes the KPERS member-employee contribution rate of 6 percent of covered salary for all members. The employer rates established by statute at December 31, 2016 and 2015, are 9.18 percent and 9.48 percent, respectively. The Hospital employer contributions to KPERS for the years ended December 31, 2016 and 2015, were \$1,176,876 and \$1,206,309, respectively, equal to the statutory required contributions for each year.

Employer and nonemployer allocations

Although KPERS administers one cost-sharing multiple-employer defined benefit pension plan, separate (sub) actuarial valuations are prepared to determine the actuarial determined contribution rate by group. Following this method, the measurement of the collective net pension liability, deferred outflows of resources, deferred inflows of resources, and pension expense are determined separately for each of the following groups of the plan:

- State/School
- Local
- Police and Firemen
- Judges

To facilitate the separate (sub) actuarial valuations, the System maintains separate accounts to identify additions, deductions, and fiduciary net position applicable to each group. The Hospital is included in the local group. The allocation percentages presented for each group in the schedule of employer and nonemployer allocations are applied to amounts presented in the schedules of pension amounts by employer and nonemployer. The allocation percentages for the Hospital's share of the collective pension amounts as of December 31, 2016 and 2015, are based on the ratio of each employer's contributions to total employer and nonemployer contributions of the group for the years ended June 30, 2016 and 2015, respectively. The contributions used exclude contributions made for prior service, excess benefits, and irregular payments. As of December 31, 2016, the Hospital's proportion was 0.771 percent which was an increase of .020 from its share at December 31, 2015.

Net pension liability

At December 31, 2016 and 2015, the Hospital reported a liability of \$11,927,118 and \$9,857,928, respectively, for its proportionate share of the net pension liability.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2016 and 2015

NOTE N - DEFINED BENEFIT PENSION PLAN - Continued

Actuarial assumptions

The total pension liability was determined by actuarial valuations as of December 31, 2015 and 2014, which were then rolled forward to June 30, 2016 and 2015, using the following actuarial assumptions:

Actuarial assumptions

Price inflation	3.00%
Wage inflation	4.00%
Salary increases, including wage increases	4.00% - 16.00%
Long-term rate of return net of investment expense and including price inflation	8.00%

Mortality rates were based on the RP-2000 Combined Mortality Table for Males or Females, as appropriate, with adjustments for mortality improvements on Scale AA.

The actuarial assumptions used in the December 31, 2015 and 2014 valuations were based on the results of an actuarial experience study conducted for the three year period ending December 31, 2012.

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation.

Best estimates of arithmetic real rates of return for each major asset class included in the pension plan's target asset allocations as of June 30, 2016, are summarized in the following table:

<u>Asset class</u>	<u>Long-term target allocation</u>	<u>Long-term expected real rate of return</u>
Global equity	47.00 %	6.80 %
Fixed income	13.00	1.25
Yield driven	8.00	6.55
Real return	11.00	1.71
Real estate	11.00	5.05
Alternatives	8.00	9.85
Short-term investments	<u>2.00</u>	(0.25)
Total	<u>100.00 %</u>	

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2016 and 2015

NOTE N - DEFINED BENEFIT PENSION PLAN - Continued

Discount rate

The discount rate used to measure the total pension liability was 8.00 percent. The projection of cash flows used to determine the discount rate assumed that contributions from plan members will be made at the contractually required rate. The State, School, and Local employers do not necessarily contribute the full actuarial determined rate. Based on legislation passed in 1993, the employer contribution rates certified by the System's Board of Trustees for these groups may not increase by more than the statutory cap. The expected KPERS employer statutory contribution was modeled for future years, assuming all actuarial assumptions are met in future years. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

Sensitivity of the net pension liability to changes in the discount rate

The following table presents the net pension liability of the pension plan as of June 30, 2016, calculated using the discount rate of 8.00 percent, as well as what the pension plan's net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower (7.00 percent) or 1-percentage-point higher (9.00 percent) than the current rate:

	1% decrease <u>(7.00%)</u>	Current discount rate <u>(8.00%)</u>	1% increase <u>(9.00%)</u>
Hospital's share of net pension liability	\$16,348,044	\$11,927,118	\$ 8,178,517

Pension expense

For the years ended December 31, 2016 and 2015, the Hospital recognized pension expense of \$1,083,706 and \$645,840, respectively, which includes the changes in the collective net pension liability, projected earnings on pension plan investments, and the amortization of deferred outflows of resources and deferred inflows of resources for the period.

Deferred outflows of resources and deferred inflows of resources

A summary of the collective deferred outflows of resources and deferred inflows of resources related to the defined pension plan at December 31, 2016 and 2015, are included in the tables below. Experience gains/losses and the impact of changes in actuarial assumptions or other inputs, if any, are

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2016 and 2015

NOTE N - DEFINED BENEFIT PENSION PLAN - Continued

recognized over the average expected remaining service life of the active and inactive plan members at the beginning of the measurement period. Investment gains and losses are recognized over a fixed five-year period.

	<u>2016</u>	<u>2015</u>
Deferred outflows of resources		
Differences between expected and actual experience	\$ 69,225	\$ -
Net difference between projected and actual earnings on pension plan investments	1,408,949	
Changes in proportion and differences between Hospital contributions and proportionate share of contributions	343,796	147,236
Employer contributions subsequent to the measurement date	<u>592,035</u>	<u>604,642</u>
Total deferred outflows of resources	<u>\$ 2,414,005</u>	<u>\$ 751,878</u>
Deferred inflows of resources		
Differences between expected and actual experience	\$ 215,272	\$ 279,057
Changes in assumptions	111,571	137,776
Net difference between projected and actual earnings on pension plan investments		383,735
Changes in proportion and differences between Hospital contributions and proportionate share of contributions	<u>98,878</u>	<u>125,386</u>
Total deferred inflows of resources	<u>\$ 425,721</u>	<u>\$ 925,954</u>

The following table provides the deferred outflows of resources and deferred inflows of resources as of December 31, 2016, that will be recognized in pension expense in future years:

<u>Year ended December 31,</u>	<u>Employer contributions subsequent to the measurement date</u>	<u>Recognition of net deferred outflows/(inflows) of resources by year</u>	<u>Total</u>
2017	\$ 592,035	\$ 172,436	\$ 764,471
2018		172,436	172,436
2019		600,759	600,759
2020		413,830	413,830
2021		<u>36,788</u>	<u>36,788</u>
	<u>\$ 592,035</u>	<u>\$ 1,396,249</u>	<u>\$ 1,988,284</u>

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2016 and 2015

NOTE O - EMPLOYEE HEALTH INSURANCE CLAIMS

The Hospital is partially self-insured for health insurance claims of its employees. The Hospital has reinsured a portion of its risk for such claims. The reinsurance arrangement covers annual claims in excess of \$65,000 for each covered individual. Covered employees also provide part of the funds to pay claims through monthly contributions at predetermined rates. The Hospital has retained an insurance company as its agent to process and settle claims. The Hospital reimburses the agent twice a month for the amount of claims paid by the agent net of any amounts covered by reinsurance.

The following is a summary of the activity under this arrangement:

	<u>2016</u>	<u>2015</u>
Estimated employee health insurance claims payable at beginning of period	\$ 151,000	\$ 140,000
Provision for employer's share of incurred claims expenses for the period	1,029,821	804,449
Employee contributions	588,939	509,455
Payments made for claims, expenses, and reinsurance	<u>(1,608,760)</u>	<u>(1,302,904)</u>
Estimated employee health insurance claims payable at end of period	<u>\$ 161,000</u>	<u>\$ 151,000</u>

NOTE P - FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is determined according to a hierarchy that gives highest priority to use of observable inputs and lowest priority to use of unobservable inputs. These inputs are described as follows:

Level 1 inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Hospital has the ability to access.

Level 2 inputs to the valuation methodology are other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3 inputs to the valuation methodology are unobservable, supported by little or no market activity, and are significant to the fair value measurement.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2016 and 2015

NOTE P - FAIR VALUE OF FINANCIAL INSTRUMENTS - Continued

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. The following is a description of the valuation methodologies used by the Hospital for assets measured at fair value on a recurring basis:

Money market funds and common stocks are valued at unadjusted quoted prices for identical securities in active markets.

Corporate bonds are valued at prices provided by an independent pricing service.

The following tables set forth, by level, the Hospital's assets measured at fair value on a recurring basis:

	December 31, 2016			
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Cash	\$ 4,967,575	\$ -	\$ -	\$ 4,967,575
Money market funds	3,752,818			3,752,818
Common stocks	24,188			24,188
Corporate bonds		1,117,660		1,117,660
	<u>\$ 8,744,581</u>	<u>\$ 1,117,660</u>	<u>\$ -</u>	<u>\$ 9,862,241</u>
	December 31, 2015			
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Cash	\$ 4,599,901	\$ -	\$ -	\$ 4,599,901
Money market funds	3,433,920			3,433,920
Common stocks	23,396			23,396
Corporate bonds		1,183,827		1,183,827
	<u>\$ 8,057,217</u>	<u>\$ 1,183,827</u>	<u>\$ -</u>	<u>\$ 9,241,044</u>

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2016 and 2015

NOTE Q - RELATED PARTIES

The Hospital is responsible for appointing members to AHI's Board of Directors. The Hospital does not make any appropriations to AHI and there is no financial benefit or burden relationship. The following is a summary of the assets, liabilities, net position, revenues and expenses, and changes in net position of AHI as of and for the years ended September 30, 2016 and 2015:

	<u>2016</u>	<u>2015</u>
Cash and cash equivalents	\$ 90,009	\$ 108,057
Other current assets	<u>36,536</u>	<u>38,361</u>
Total current assets	126,545	146,418
Investments	169,344	145,371
Capital assets - net	1,017,506	1,010,139
Other assets	<u>22,878</u>	<u>23,043</u>
Total assets	<u>\$ 1,336,273</u>	<u>\$ 1,324,971</u>
Accounts payable	\$ 24,566	\$ 20,538
Current portion of mortgage payable	100,210	96,979
Other current liabilities	<u>2,369</u>	<u>2,901</u>
Total current liabilities	127,145	120,418
Mortgage payable, excluding current portion	444,220	544,426
Other liabilities	<u>22,275</u>	<u>22,365</u>
Total liabilities	593,640	687,209
Net position	<u>742,633</u>	<u>637,762</u>
Total liabilities and net position	<u>\$ 1,336,273</u>	<u>\$ 1,324,971</u>
Revenues	<u>\$ 529,935</u>	<u>\$ 497,865</u>
Management fee paid to Hospital	59,519	58,436
Depreciation and amortization	93,359	77,979
Other expenses	<u>272,186</u>	<u>265,823</u>
Total expenses	<u>425,064</u>	<u>402,238</u>
Increase in net position	<u>\$ 104,871</u>	<u>\$ 95,627</u>

There were no contributions received from the Memorial Health Foundation in 2016 or 2015. The Foundation reimbursed the Hospital \$34,142 in 2016 for the cost of salaries and supplies paid on behalf of the Foundation. At December 31, 2016, the Foundation had total assets of \$119,168 and a net position of \$116,376. The Foundation is not included in these financial statements as management does not consider it to be significant in relation to the Hospital.

REQUIRED SUPPLEMENTARY INFORMATION

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS
SCHEDULE OF HOSPITAL'S PROPORTIONATE SHARE OF
THE NET DEFINED PENSION PLAN LIABILITY
December 31,

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Hospital's proportion of the net pension liability	0.7710%	0.7508%	0.7610%
Hospital's proportionate share of the net pension liability	\$11,927,118	\$ 9,857,928	\$ 9,366,352
Hospital's covered-employee payroll	\$12,820,000	\$12,724,778	\$12,373,292
Hospital's proportionate share of the net pension liability as a percentage of its covered-employee payroll	93.04%	77.47%	75.70%
Plan fiduciary net position as a percentage of the total pension liability	68.55%	71.98%	72.56%

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

SCHEDULE OF HOSPITAL CONTRIBUTIONS TO

DEFINED PENSION PLAN

December 31,

	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
Contractually required contribution	\$ 1,176,876	\$ 1,206,309	\$ 1,093,799	\$ 980,318	\$ 846,955	\$ 708,487	\$ 564,790	\$ 432,545	\$ 308,271	\$ 268,955
Contributions in relation to the contractually required contribution	<u>(1,176,876)</u>	<u>(1,206,309)</u>	<u>(1,093,799)</u>	<u>(980,318)</u>	<u>(846,955)</u>	<u>(708,487)</u>	<u>(564,790)</u>	<u>(432,545)</u>	<u>(308,271)</u>	<u>(268,955)</u>
Contribution deficiency (excess)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Hospital's covered-employee payroll	\$12,820,000	\$12,724,778	\$12,373,292	\$12,346,727	\$11,539,034	\$10,511,925	\$9,198,578	\$7,807,682	\$6,252,952	\$6,240,261
Contributions as a percentage of covered-employee payroll	9.18%	9.48%	8.84%	7.94%	7.34%	6.74%	6.14%	5.54%	4.93%	4.31%